

Audit's NEWS ANALYSIS OF SECURITIES OF REAL ESTATE INVESTMENT TRUSTS

Realty Trust Review

June 13, 1975

VOL. VI, No. 11

VALUE GUIDE TO TRUSTS REVIEWED THIS ISSUE

Trust	Rel. Appeal	Port. Yield	-12Mo. Port. Last	Chng. E.Next	Lever. Ratio	Price	Ann. Yield*	Div. Reinv.	Page
RAM Pacific	3	9.84%	+3%	+20%	0.75	\$8.13	14.8%	No	6
Saul (B.F.) REIT	5	8.91	+1	0	1.83	4.00	0.0	Yes	7
Security Mtg.	5	6.01	-4	0	2.84	1.00	0.0	No	8
AVERAGE		8.25%	0%	+ 7%	1.81		4.9%		

*Based on annualized latest qtr.

Bank rescue efforts for troubled REITs could be stymied by new accounting rules..1
 Details of nine recent contingent-interest revolving credits plus comments
 on Chase Manhattan Trust, Citizens Mortgage Inv. Trust, Cousins Mtg. & Equity
 Some Kassuba properties getting closer to transfer.....5

BANK RESCUE EFFORTS FOR TROUBLED REITs COULD BE STYMIED BY NEW ACCOUNTING RULES

Two major forces are converging on the troubled construction lending REITs and investors so far have been focusing on one while seemingly unaware of the other. It is impossible to invest or speculate in REIT securities without a clear understanding of both.

---Commercial bank rescue efforts. Bank lenders are now nearly unanimous on the need to keep troubled REITs alive. Their latest vehicles are contingent-interest deals, now coming in a bewildering complexity for investors, that will effectively keep interest charges from eroding shareholders' equity for many REITs.

---Accountants' tightening of loss reserve rules. The accounting profession is expected to begin soon enforcing a controversial rule that would increase loss provisions for some trusts--by amounts large enough to throw a few REITs into negative net worth.

The new spirit of cooperation between banks and their REITs is being greeted exuberantly by investors because the restructuring of bank revolving credit agreements is bringing sharply lower base interest rates with it. Last week Continental Illinois Realty shares soared 31% on news of a new loan agreement carrying a 4% base rate; the news aided other major bank-sponsored REITs and Citizens & Southern Realty was ahead by 37% and Chase Manhattan Trust 16%. But the new contingent interest plans may not be an unmixed blessing for REITs and so it's worth examining details.

1. Contingent interest plans. Nine plans announced to date provide some form of contingent interest on \$2.08 billion of REIT debt to banks, or about 29% of the \$7.2 billion of REIT revolvers now completed or in negotiation by 52 REITs, mostly short-term construction lending trusts. The plans vary widely but have one

KENNETH D. CAMPBELL, EDITOR AND PUBLISHER, BERNARD SOLAS, C.F.A., DIRECTOR OF RESEARCH / AUDIT INVESTMENT RESEARCH, INC., 230 PARK AVENUE, NEW YORK 10017

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common purpose: preserve shareholder equity. In effect the banks are saying that shareholder equity is there to absorb investment losses but not for paying the interest burden. The contingent interest generally is to be paid from future profits over the next ten years or so. What banks seem to be saying is they are allowing five years for the real estate to recover and another five to pay contingent interest. But there are two problems:

They could force eventual disqualification as a REIT. REITs must pay 90% of income to shareholders as dividends but the revolvers generally require payment of various percentages of future profits as interest also. It's not at all clear what will happen when these two requirements collide sometime in the 1980s but it adds new accounting and tax uncertainties to REITs.

Accounting treatment is unclear. REITs and banks are hoping the amount of deferred interest will be shown only as a footnote contingency, not as a specific liability and thus deductible from shareholder equity. Some accounting firms have already given preliminary approval to this treatment, although again uncertainties exist. Note that Heitman Mortgage, shown below, will accrue interest on its contingent interest at a full 130% of prime while the others expect to accrue at lesser percentages. Details of the agreements:

✓ Chase Manhattan Trust: Proposal expected to be finalized by June 30, 1975 on \$761 million line would set interest at 2%, payable monthly, plus paying all available cash flow to provide interest to 115% of prime. Shortfall below 115% of prime accrues at 126% of prime and is payable from future trust profits under formula not further divulged; profit sharing would be phased out over five years beginning in calendar 1983.

✓ Continental Illinois Realty: New \$222 million agreement announced June 6, 1975, sets interest at 130% of prime but only 4% becomes a fixed obligation; difference to 130% of prime is payable as contingent interest and payable out of future recovery on non-earning investments. Trust agrees to maintain \$50 million net worth, including \$25 million of 7 5/8% senior subordinated notes.

✓ Continental Mortgage Inv.: Announced May 29 agreement on new terms as follows: For \$531 million domestic bank debt, rate reduced to lower of prime rate or 6½%, from 130% of prime. For \$80 million Eurodollar debt, to Eurodollar rate from 2% over such rate. Rates effective Jan. 7, 1975 retroactively. Rates could rise if trust profit exceeds renegotiated rates and if interest rates exceed trust profit, such excess charges are deferred till Dec. 1, 1975. Agreement reduces significantly \$16.4 million of interest due April 1, 1975.

✓ First Mortgage Investors: Preliminary understanding, expected final by Aug. 21, 1975, to cut interest rate from 130% of prime rate to greater of 1% or 100% of available net cash flow from operations up to Federal Reserve discount rate (now 6%); any unpaid interest would accumulate until April 30, 1986, when it would be forgiven. Bank lenders under \$400 million line would convert \$25 million of interest accrued between Sept. 1, 1974 and Jan. 31, 1975, into 4% non-voting preferred stock, with preferred cumulative for two years and stock convertible into shares at \$7. In addition insurance company lenders of \$50 million private subordinate notes would take \$5 million cash now and convert \$45 million principal into non-dividend, non-voting preferred subordinate to bank preferred. This preferred convertible at \$10 per share. Other terms require holders of "substantial amount" of 9% senior notes due Nov. 1, 1978, to refrain from exercising option for early principal payment on Nov. 1, 1975. Interest on all publicly held debt would continue to be paid if 9% noteholders agree to

these terms.

First of Denver Mortgage Investors: Effective May 1, 1975, interest on \$107.2 million is set at all available cash flow before depreciation monthly, with the difference to the prime paid in senior notes. Then the difference to 130% of prime is taken in 10-year notes, payable only from 50% of net income.

First Wisconsin Mtg. Trust: Lending banks agreed March 26, 1975 to extend trust's \$176.5 million line, to reduce compensating balance requirements on such line from 13.6% to approx. 6%. Interest remains at 107% of prime, cutting compensating balances from \$24 million to \$10 million. Interest is deferred till Aug. 1, 1975, with all interest to be up to date by Dec. 31, 1975. Agreement also contains a \$165 million revolving credit, expiring March 31, 1976, which will not become effective till trust debt/equity ratio falls to 5-to-1 (vs. 7.19-to-1 when agreement signed). Trust would pay 25% of net profit of each of next five profitable years in next 10, until March 31, 1986, as contingent interest for amounts remaining unpaid.

Great American Investors: Interest on \$271 million reduced in May 1975 from 130% of prime to prime, payable in either cash (and effectively available net cash flow) or at the trust's option, non-interest bearing notes, half in senior interest notes senior to all debt, and half as capital interest notes, junior to all other debt except pari passu with existing 7% subordinate debentures.

Heitman Mortgage Investors: Arranged one-year \$154.5 million line June 3, 1975, setting interest at 130% of prime, with prime rate paid in cash on quarterly basis; any additional earnings over prime in either calendar 1975 or five months to May 31, 1976 will be paid to banks; any shortfall to 130% of prime will be paid in income notes, non-interest bearing, payable only from future income and with no maturity.

National Mortgage Fund: Effective April 1, 1975, interest for \$57.5 million revolver and \$5 million Eurodollar loan cut from 130% of prime to base 6% interest, with difference between 6% and 1% over prime contingently payable from future profits through March 31, 1985. Contingent interest payable based on formula as follows: If \$45 million loans outstanding, trust pays 100% of REIT income; if \$40-45 million out, 93%; if \$35-40 million out, 86% of income, etc. Agreement replaced revolver expiring July 31, 1975.

2. Proposed accounting rules on loss reserves. The accounting profession is about ready to require REITS to report their problem properties at values discounted for the cost of money and other holding costs. The rule has been fiercely disputed by a number of REITs because application would almost surely throw a number of large and highly leveraged REITs into negative net worth positions--i.e., their accounting statements would show no book value, or equity, left for shareholders.

The proposal's status is as follows: the REIT Task Force of the American Institute of CPAs and the Accounting Committee of the National Assn. of REITs have both approved position papers which basically will require REITs to deduct estimated holding costs, including the cost of money, from the values of property acquired through foreclosure or in lieu of foreclosure. These holding costs would include any estimated completion costs, selling or leasing costs, property taxes, legal fees, maintenance, and money costs.

This money cost, discounted to present value, is the most controversial item. It would be defined as the weighted average cost of all trust capital, including

shareholders' equity at zero interest. Thus an unleveraged trust would have no interest cost, while a highly leveraged trust would have a much higher interest cost (although perhaps lowered by interest rate reductions on bank debt). Holding costs for the entire estimated holding period would be deducted in the year in which property was acquired; in future years some part of this cost would be credited to the income statement to match approximately costs actually being incurred in those years, thus producing zero impact on future income statements from current foreclosures. Accountants say this is done so future shareholders will not be burdened by costs of present events.

Some accounting firms are already enforcing the new rules and it's possible to see the major impact of holding costs. Holding costs accounted for over half (\$20.5 million) of the \$39.3 million added to loss reserves by Builders Investment Group in its September 1974 fiscal year. How the new system is applied to specific properties was described at NAREIT's accounting conference last week by Peyton Fletcher, president of Mortgage Investors of Washington. The trust took title to an 80,000 sq. ft. warehouse on which it had made a \$1.2 million loan based on a \$1.5 million appraisal. It was 20% rented at \$2/sq. ft. Accountants calculate the value at \$930,000, using the additions and deductions shown in the table (thousands of dollars). An insurance company appraised the warehouse at \$1.2 million and gave the trust a \$900,000 loan at 9 5/8% for 25 years. "If we take the accountant's approach to value, management should give the warehouse at this time to the insurance company," says Fletcher, one of the industry's strongest foes of the proposed new rules. Instead of getting facts, he complains, shareholders will be getting a flood of assumptions about

Mortgage amount.....	\$1,200T
Add: Rent income for 2 yrs.....	64
Est. future rents.....	50
Less: Cost of money for 2 yrs...	(204)
Est. sales comm. if sold..	(60)
Oper. exp.(taxes, utilities)(	80)
Possible tenant work.....	(40)
Present value.....	\$ 930T

interest costs, estimated holding periods, and many other smaller details. Making these assumptions is so complex and subject to such wide variations between accounting firms that results are meaningless to small investors, he and many others in the industry are saying. They are also complaining that accountants do not appear disposed right now to apply these new rules to the commercial banks and other financial institutions, saying these entities have established loan loss practices which have worked well in the past. The net result is that the short-term construction lending REITs will doubtless become the villains in the 1970s real estate debacle.

The more immediate result is to raise the potential for many REITs to wind up with balance sheets showing no shareholders' equity in the very near future. Already First Mortgage Investors effectively had its equity wiped out and forced banks and life insurance companies to convert \$70 million of debt and back interest into preferred stock. National Mortgage Fund reported it lost \$18.7 million in its February 1975 fiscal year, mainly because of loss provisions, and cut shareholders' equity below \$6 million. The NYSE has halted stock trading while checking NMF's continued listing qualifications. Citizens Mortgage reported loss provisions melted equity to \$9.4 million in 1974. Our fear is that some trusts with May, June or July fiscal years will come up with skimpy balance sheets; this category has to include Chase Manhattan Trust, down to \$30 million equity at February; LMI Investors, Great American Investors, First Virginia Mortgage, Independence Mortgage, and Texas First Mortgage. Negative net worth or sharply reduced net worth sets off all sorts of vibrations in the financial community that could inhibit bank rescue operations. Some of these:

a. Commercial banks. Banks generally tell outsiders they prefer to focus on the sum of shareholders' equity and accumulated loss reserves, because the money hasn't left the trust. But if accountants' judgments are close to target, it's only

a matter of time till that cash leaves the trusts. Moreover, publication of a balance sheet with no equity apparently triggers an entire set of internal changes for banks, especially treatment of loans by bank examiners, because negative worth raises serious questions about recovery of loan principal. Banking examiners are especially close-mouthed on this point. But such statements could trigger some charges to bank loan loss reserves. It's clear banks are using their most creative loan structuring to preserve book value. All but one of the new contingent interest deals (above) has this purpose. Great American and its lenders have already agreed they will not recognize reductions in book value resulting from any accounting changes--i.e., from imposition of the holding cost rule. Some of the other loan agreements may contain similar outs.

b. Indenture trustees. The impact of reduced book value on indenture trustees under the REIT industry's many convertible and straight debt issues is just beginning to surface. Its impact is potentially more powerful because indenture trustees, being bound by fiduciary obligations, cannot simply waive "covenant defaults". That phrase is important because it means that various covenants in the trust's indenture covering a public debt issue are in default. Trust departments of major banks are generally designated as indenture trustees to represent bondholders' interests. It's well known that commercial bank lenders are continuing to pay interest on nearly all public subordinate debt because they fear they cannot get the 100% approval of bondholders that's generally needed to change any interest or principal payment requirement.

But covenant defaults to date have been handled within trustee's discretionary powers to advise bondholders of their rights but not accelerate principal payments. The current example: Citizens Mortgage Trust is now in covenant default because its \$20 million issue of 8½% senior subordinate notes, due 1980, exceeds 115% of its \$9.4 million net worth. The trustee, Chemical Bank, has advised debenture holders that 10% of holders may demand the trust cure the default, but so far only \$5,000 principal amount has demanded such curing. Trustees seem to be saying they'll make no demands for acceleration of principal so long as commercial banks continue to fund interest payments.

In this vein, Cousins Mortgage has defaulted on its June 2 interest payment on \$10 million variable rate notes to the Ford Foundation. The Foundation note is due Nov. 1 but the interest default could trigger demand for early payment. Also First National Bank of Pensacola, Fla. has sued to recover \$1 million loaned the trust.

SOME KASSUBA PROPERTIES GETTING CLOSE TO TRANSFER

Slowly, inexorably, a significant portion of the Kassuba complex is approaching reasonably satisfactory resolution. Mr. Kassuba was the largest U.S. apartment developer/owner when he filed bankruptcy in Dec. 1973. His properties then had estimated market value of \$528 million and long term liabilities were listed at \$403 million. These liabilities were spread around to about 200 secured creditors and 2,000 unsecured creditors. The ripple effect took in much of the real estate industry including several real estate trusts.

The biggest break to resolve over half Mr. Kassuba's holdings was an offer in June 1974 by a Los Angeles group put together by John Kusmiersky to buy a package for \$282 million. The bankruptcy court approved this transaction last June. The Kusmiersky package contains most of the large properties financed to some degree by publicly held trusts, hence progress is of interest to the investment community. Although little progress is visible in completed transactions, we understand many

are winding along, apparently close to conclusion. Although only one buyer, the Kusmiersky group, and one seller, Mr. Kassuba, are involved regarding the equity, each property has different creditors. These range from mortgagees and land lessors to unsecured creditors and tax assessors. Additionally, new bank and insurance companies are brought in to put up new money where needed and warranted. Hence each deal has been worked on individually involving its own army of creditors.

The inherent complexity of each transaction has been further compounded by changes wrought by time, mainly tax arrearages piling up and physical aging of the properties. Kusmiersky is reported to have done a good job of day-to-day maintenance but no capital improvements were made while ownership was in bankruptcy limbo. Thus changes from original agreements were necessitated by some creditors which on balance will probably result in delaying near-term income to provide tax arrears and capital improvements. With negotiations still hanging fire, it is difficult to say how many are being brought to conclusion. The best estimate is that about 40 of the original 60 properties agreed to be purchased by the Kusmiersky group will be transferred to them with the balance left to be disposed of through the court. Apparently there are two types of stumbling blocks. One is where the property cannot support either additional funding to satisfy a new creditor or where the property doesn't support all existing creditors and the second is where negotiations just cannot be conducted to the mutual satisfaction of all parties.

In any event, we should shortly see some trusts get their properties out from the bankruptcy court with viable long-term positions. Earning power from the Kassuba situation will likely remain impaired for a while but this appears preferable to leaving property tied up in bankruptcy court from where discounted present value is usually inferior.

REALTY AND MORTGAGE INVESTORS OF THE PACIFIC (8 1/8--OTC-RPACS) FY Nov. 30							
Quar.	Port.	Port.Yld.	Non-earn.Inv.	EPS Prim.	Div.	-Price range-	Yld.range
5/74	\$74.3M	11.48%	0.0%	\$0.42	\$0.42	\$13.75-9.00	18.7-12.2%
8/74	75.3	10.49	0.0	0.31	0.30	9.63-6.88	17.4-12.5
11/74	78.9	11.04	0.0	0.32	0.30	9.75-4.75	25.3-12.3
2/75	82.6	9.84	3.3	0.30	0.30	9.25-5.38	22.3-13.0

Portfolio dynamics: Fundings increased 3% over the past year. The portfolio is expected to grow 28% over the next 15 months to mid-1976 (peaking at \$105M) based on present commitments. These fundings will be in lower risk type investments: standing loans and equity, with little construction lending. Loan type breaks down: 33% long term, 22% standing (non-amortizing loans up to ten years), 21% construction loans, 9% land leasebacks, 5% equity, 6% land and land development and 4% junior. About 15% of funded investments are tied to prime but 39% of commitments are so tied. The geographic area covered focuses in and around the Pacific Ocean, an area well known to the adviser: 41% California, 25% Hawaii, 9% Guam, 5% Fiji, 4% Arizona, 4% Indonesia, 2% Oregon, 4% Mexico and 3% New Mexico. The entire portfolio by loan type is 26% hotels and motels, 22% apartments, 14% office buildings, 7% land development, 4% garages, 4% golf & tennis clubs, 4% each industrial and shopping centers, 1% each theaters and mobile home parks; while the remaining 12% is equity. The construction loans accent apartments and longer term loans hotels/motels, the latter catering heavily to Hawaii tourists. There are now three problem loans for \$6.4M, 7.7% of portfolio, still below average. There is \$2.76M on a condo-townhouse in Arizona which was sold to a new company and the loan rewritten. On a cash basis, the loan is to be repaid as the units are sold. Moving slowly, the units average \$54,000. There is \$2.2M on the Guam Horizon, a TLA (transit living allowance) development. The trust is trying to get possession to sell. Two loans for \$1.4M were made on a motel in Escondido, Cal. to Royal Inns America, now in Chapter 10 bankruptcy. RAMPAC requested the property from the bankruptcy trustee as it believes there is no equity left.

Financing: The trust is financed 57% capital and 43% non-convertible debt. Capital \$47M, is 75% equity (1.89M shares) and 25% converts. Debt of \$35M is 56% short term bank notes and 43% commercial paper (rated P-1 by Moodys and Fitch). Bank credit lines were recently increased to \$40M to cover intended standing loans. About 43% of funds float with market rates. Sponsor: Bank of Hawaii, largest commercial bank in the central Pacific. Results & outlook: The trust maintained its \$0.30 dividend of the last three quarters with the May declaration, fine relative achievement only 33% below the peak payment. Loans to be placed over the year should be incrementally profitable as they will be tied to market rates locking in a spread on borrowings. The shares have considerable speculative appeal for the current yield of 15% and sell 58% below book value which looks reasonably secure. To better reflect real estate uncertainties, the loss reserve provision was raised to 5% of earnings from 3%, although the reserve is low compared to other trusts. There is little doubt of the trust's capabilities in its geographic area and its prudence not to go beyond these capabilities. The risk is the trust's heavy participation in outlying islands and these properties' reliance on lengthy air transportation. Any renewed upsurge in oil prices might impact Hawaiian resort travel although this activity has remained very strong to date, even in face of the recession. (BS)

B. F. SAUL REAL ESTATE INVESTMENT TRUST (4--NYSE-BFS) FY Sept. 30

Quar.	Port.	Port.Yld.	Non-earn Inv.	EPS Prim.	Div.	-Price range-	Yld.range
6/74	\$312.8M	14.19%	5.3%	\$0.34	\$0.28	\$11.00-8.50	13.2-10.2%
9/74	311.7	12.97	4.7	0.08	0.15	8.63-3.75	16.0- 7.0
12/74	319.7	11.12	24.7	d0.22	0.00	6.50-2.75	0.0- 0.0
3/75	316.2	8.91	28.6	d1.95	0.00	5.25-3.13	0.0- 0.0

d-deficit

Portfolio dynamics: The portfolio grew 1% the past year and at Mar. 31 was 43% real estate owned (including acquired property amounting to 13% of the portfolio) and 57% mortgages. The trust is making no new deals except for workout situations. No real growth is anticipated in the next year beyond completion of existing loans. At Mar. 31, the trust had \$18 million in loan commitments and \$4 million in land leaseback commitments. Standby commitments amount to \$30 million. Saul has enough money to fund these commitments. At Mar. 31, the trust held \$49.4 million cash and although some was compensating balances, the bulk was in short-term investments. By property type the portfolio is 37% apartments and townhouses, 30% shopping centers, 14% office and industrial, 9% hotel and motel, 8% condominiums and 2% other. The majority of investments are in Md. and Va. Mortgage loans are located in nineteen states and Washington, D.C., with some concentration in Fla. According to management, the real estate portion excluding properties acquired through foreclosure is doing well with apartments 98% leased and shopping centers 97% leased. Most acquired property holdings are completed and experiencing good leasing progress; some are even producing modest income. At present, Saul has 20 loans amounting to \$47.7 million or 15% of the portfolio on which it is not accruing interest. In addition 21 properties for \$42.6 million have been acquired through foreclosure, representing 13% of the portfolio. The 21 acquired properties are 13 apartment projects, 3 offices and warehouses, 3 condominiums, one shopping center and one motel. Saul has stayed with standard income properties and has had a good track record of turning acquired properties into income producers. Four holdings, 2 apartments and 2 shopping centers, acquired in the past are now producing good cash flow. Leasing at its acquired property holdings is moving along well and strengthening is seen in the real estate market.

Financing: Saul is funded 35% capital and 65% by non-convertible debt. The \$125.2 million in capital is 50% equity with 5.66 million shares, 24% in 6½% convt. subor. debent., 20% in 8½% subor. notes and 6% in 8% convt. subor. debent. Debt of \$229.4 million is 68% in short-term bank loans, 17% in secured mortgages, 11% term loan and 4% senior notes. About 51% of funds float with market rates. Saul has \$173.5 million in domestic bank lines and \$5million in foreign lines. Management feels it has suf-

ficient cash and credit to meet its commitments and has not asked or been forced into a revolver. Sponsor: B. F. Saul Company, a Washington, D.C. mortgage banking and real estate company. Results & outlook: Addition of \$8.4 million, or \$1.48/sh., to the loss provision caused the March qtr. loss. Saul also experienced a drop in its gross revenues, largely attributable to its non-earning loans. Management looks for a loss in fiscal 1975 but anticipates being profitable in 1976. Saul is working well with turning its non-earning loans around but the process is slow, even with its strong real estate management capabilities. The shares represent a speculation that properties can be restored to health before heavy interest charges erode shareholders equity and bring liquidity problems. They are ranked No. 5 (no dividend) with an asterisk indicating sound underlying value. (VCK)

SECURITY MORTGAGE INVESTORS (1--ASE-SMO) FY Sept. 30							
Quar.	Port.	Port.Yld.	Non-earn.Inv.	EPS Prim.	Div.	-Price range-	-Yld.range-
6/74	\$212.2M	10.53%	27.5%	\$0.00	\$0.00	\$5.63 - 3.00	0 - 0%
9/74	209.2	7.32	32.8	d0.61	0.00	1.88 - 1.00	0 - 0
12/74	202.3	7.53	35.2	d0.18	0.00	1.88 - 0.50	0 - 0
3/75	202.7	6.01	39.1	d0.32	0.00	1.88 - 0.63	0 - 0

d-deficit

Portfolio dynamics: During the past twelve months the portfolio decreased 4% and some runoff in the portfolio is expected the next year. The trust is prohibited from making new commitments under its revolving credit agreement. Security has \$5.1 million in unfunded commitments on existing mortgage loans and liquidity is sufficient to fund them. The trust also has \$3.4 million in standby commitments not expected to fund. Investments by type of loan are 43% first mtg., 36% junior mtg., 20% construction and 1% equity (land purchase leasebacks). Project type breaks down: 39% single family, 20% commercial, 17% health care, 14% multi-family and 10% land and land development. Investments are in 38 states with some concentration in Fla., Tex. and Calif. Very few construction loans are presently floating since most are non-accruing. At Mar. 31 total non-accruals amounted to \$79.3 million or 39% of investments. Some \$25.2 million of non-accruals were loans in process of foreclosure or foreclosed property. (Actual properties acquired amounted to \$8.4 million.) These properties included 7 apartment projects, a motel, a condominium and 9 parcels of land plus already-acquired unimproved land in Tex. and N.C. and notes on apartments in Calif. Some \$54.1 million of non-accruals were mtg. loans, mostly construction. The \$54.1 million includes \$39.3 million from NAAC (North American Acceptance Corp.). NAAC filed Chapter XI bankruptcy petition Feb. 6, 1974. The trustee of NAAC stopped remittances to Security as of May 1974 claiming, among other things, that Security does not own the loans being serviced by NAAC. A pre-trial hearing originally set May 5 was postponed until July 1. Collections on the portfolio serviced by NAAC are being deposited in a court account. It appears that final resolution of the NAAC proceeding will take some time. Security recently received premission from its shareholders and most debenture holders to permit it to operate as a non-qualified REIT. Management at present does not plan to leave REIT status.

Financing: Security is funded 44% capital and 56% by non-convertible debt. Of the \$89.6 million capital, 60% is in equity with 6.79 million shares and 40% in various debentures. Debt of \$115.6M is 71% short-term bank loans and 29% debentures. About 40% of funds float with market rates. In Nov. 1974 Security concluded credit agreement of \$80.6M carrying interest at 127.5% of prime and no compensating balances. Management expects this agreement to be renewed when it expires Nov. 14, 1975. Sponsor: Semorco, Inc., the adviser, is four-sevenths owned by Smith Barney Real Estate Corp. Results & outlook: The past three quarters' earnings were adversely affected by sharply reduced revenues resulting from increased non-accruals. Problem investments outside NAAC appear manageable where the trust looks capable of handling its problems. Shares have interesting speculative possibilities, 90% below book value, based on successful resolution of NAAC loans which would go a long way to preserve equity. (VCK)